

*“In that sense, the history of capital accumulation is the history of class struggles, of political movements, of the affirmation of ideologies, and of the establishment of forms of domination and reactions against them.”(Cardoso, 1977)”*

Emiliano Cabrales

# Contemporary Dependency

## The Challenges of the Developing World

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<p>Abstract.</p> <p>The article argues about the consequences of the entry of the Capitalist system into the world during the XX century and the repercussions it had on the construction of economy and society around the world. The analysis contemplates two of the biggest inventions of capitalism, Free Trade and Finance, and it focuses on the relations that join the developed world and the Third World, and the ties of <b>dependency</b> that arose historically in the process of integration of the new system, and these inventions. It will indeed provide historical evidence of the limitations of capitalism for the developing countries and the dangers that threat the whole world.</p>	
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## 1. Introduction

“Today we are revisiting the need to think of humanity, of all human beings”<sup>1</sup>, those are the words of Henrique Cardoso talking about the utopia of the actuality. I quote these words because I believe that is the main challenge of our world today. As he suggests, it is impossible for a Nation these days to live isolated from the rest of the world. Thus, our main concern is to find ways of cooperation and aid thinking as the humanity as a whole and not just as a group of people, as a clan, or as a party. Cardoso says however that we must respect diversity and the culture, but there are some basic rights that should be global. Sadly, history has not had the same principles of Cardoso. On the contrary, the XX century would be the perfect scenario for cutting the world in two. The "Developed" and the "Underdeveloped".

This paper will include a literature review that will provide with and historical overview of the problems that emerged during the XX century when the underdeveloped economies entered in the capitalist system. This literature will provide explanations of the dependency ties that result from this integration and its impact on the global economy. It will then comment on the actual trends of the capitalist development but specifically from international trade and finance and always with the perceptions of the “Dependency School” all in an effort to find new expressions of dependency and forecast the future of the developing world.

### 1.1 Research Methods

All the information and data presented in this paper is from secondary sources. Mainly from academic books, essays, and magazines. These sources are the most convenient because of the broadness of the topic that requires global analysis that could only be carried out by global institutions. This paper compiles a strong theoretical framework based primarily on the theories of economic dependency, but also a concrete historical reconstruction of the economy in the last century that sets the basis for a more recent analysis of the facts.

World financial institutions as the World Bank, the IMF or the particular Central Banks of each country will be crucial in the process of analysis of macroeconomic indicators which will serve as arguments for backing up or not any hypothesis of dependency. The confrontation between these indicators and the authors' hypothesis will bring up different points of discussion that would be discussed in the results.

The next part of this paper will analyze the different ties of modern dependency, their economic implications, and the political and social responses (if any) for achieving independence in the

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<sup>1</sup> FFMSPT (Foundation Francisco Manuel Dos Santos). (09/05/2013). Interview with Fernando Henrique Cardoso. (Video file). Findable at: <https://www.youtube.com/watch?v=Fcixj8uKxgg>

Third World.

## 2. Literature Review

The core literature of this work will be the dependency school for its precision in the analysis of international trade and industrial development. Nevertheless, it is necessary to review some basic economic terms in order to understand the theories of the Dependency School. Also in this framework, the movement of the NIEO (New International Economic Order) will be studied in order to provide information about the attempts of the developing countries to break the patterns of domination and industrialize and the response of the Center Countries to those attempts. At last, a short review will be made on the principal economic measures taken by the United States through the XX century when its hegemony begins and when the dependency of the third world was settled.

### 2.1 Basic terms

For understanding the principals of the Dependency School it is necessary to define some basic economic terms. This School looks at the relationship between Developed and Developing countries in terms of trade and its effects. That being said, the first definition that should be provided is the one for “International Trade”.

International Trade, defined as “the exchange of goods, services and capital across national borders”<sup>2</sup>. Along with this definition, it is very important to say “why” is it that international trade happens. The works of Adam Smith (1776) and David Ricardo (1817) explain that trade is possible and necessary because some countries have some advantages producing some specific kind of products over other countries. Absolute Advantages for Smith, and Comparative for Ricardo. Anyways, the fact is that nations are interested in trading because they could purchase goods they cannot produce within their territory or they produce inefficiently.

Consequently, International Trade has its effects on each nation’s economy. For understanding those effects, economics look at the Balance of Payments that is the accounting of a country's international transactions for a particular time period. This account includes "the current account, which mainly measures the flows of goods and services; the capital account, which consists of capital transfers and the acquisition and disposal of non-produced, non-financial assets; and the financial account, which records investment flows.”<sup>3</sup> All of the three accounts

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<sup>2</sup> Stephen Simpson. Macroeconomics: International Trade. Investopedia. Findable at: <http://www.investopedia.com/university/macroeconomics/macroeconomics11.asp>

<sup>3</sup> Federal Reserve Bank of New York. “Balance of Payments”. Findable at: <https://www.newyorkfed.org/aboutthefed/fedpoint/fed40.html>

are important for the study because countries could have different kinds of dependencies. The Dependency School theory concentrated in the balance of trade, which is included in the current account, and which will be one of the pillars of this thesis. However, the capital and financial accounts are not to be neglected because of the importance of “debt” and “foreign investment” in the history of developing countries’ economy.

## 2.2 Dependency School

As it was stated before, one of the main pillars of this investigation will be the Dependency School. It is important to highlight that within the dependency school's authors there are some differences regarding the various points of dependence and the weight of institutions and the state in any relation of dependency. However, the main statement of this ideology is that there are basically two groups of countries in the world; the rich and developed countries called the "Metropolis" or the "Center Countries" and another group of poor and underdeveloped countries called the "Periphery" or the "Satellites" and that these last ones are meant to serve the first ones in becoming more rich and powerful. (Frank. 1966)

### 2.2.1 Raul Prebisch

The first theory that will be studied is the Prebisch – Singer hypothesis that the countries in the periphery do not obtain a real benefice from trading with the Center Countries because of the differences in the goods they trade. Thus, the price of primary commodities declines relative to the price of manufactured goods over the long term, which causes the terms of trade of primary-product-based economies to deteriorate.<sup>4</sup>

Raul Prebisch was an Argentinian Economist, who, from 1930 to 1963, worked for the Central Bank of Argentina, the Finance Ministry, he was director of the United Nations Conference on Trade and Development (UNCTAD) and Executive Secretary of the United Nation's Economic Commission for Latin America and the Caribbean (ECLAC).<sup>5</sup> Prebisch started to study the Latin-American trade system just after the prices of basic products dropped dramatically after 1929 and arrived at the conclusion that this drop was not only due to the crisis but was a

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<sup>4</sup> CEPAL (*Economic Comision for Latin America and the Caribe*). *Terms of trade – Raul Prebisch and the challenges for the XXI century*. Findable at: <http://prebisch.cepal.org/es/sigloXXI/terminos-intercambio>

<sup>5</sup> CEPAL. “About ECLAC: Former Executive Secretaries”. Findable at: <http://www.cepal.org/cgi-bin/getprod.asp?xml=/noticias/paginas/5/14295/P14295.xml&xsl=/tpl-i/p18f-st.xsl&base=/tpl-i/top-bottom.xsl>

constant for Latin-American products.<sup>6</sup> Indeed, Prebisch used several concepts for explaining this phenomenon.

The first, Income Elasticity, refers to the relation between the changes in the percentage of the demand of a good and the percentage of the income. Prebisch explains that countries that produce basic products (nonmanufactured) experience a detriment in the terms of trade with industrialized products because an augmentation in the income of the people in the Center Countries does not represent a symmetric augmentation in the demand for basic products.<sup>7</sup> For example; if one person in the United Kingdom increases its income he could buy one cup of Brazilian coffee per day, if its income continues to increase then he could afford to buy another cup of coffee, but if his income increases more and more he will not buy 10 cups of coffee per day or he could get sick. On the other hand, if the income of one Brazilian worker increases he could buy a T.V, if it continues to increase he would probably get a DVD player, then he will go more often to the movies, then maybe buy some luxury clothes and so on. In that logic, it is correct to affirm that basic products respond to the basic needs of human beings, and ones those are fulfilled people will look towards goods and services for entertainment and confort, and those do not grow from dirt. So, there is an imperative need for industrialization in the Periphery and start producing those kinds of goods, however, to industrialize it is necessary to import machinery and technology in order to do it fast, and the Center is not always willing to share those. This is, unfortunately, the first point of dependency.

Secondly, there is this notion of Retention of Productivity Gains, which refers to the way people experience better productivity. In countries of the Center, characterized by a relatively homogeneous productive structure and higher productivity than countries on the periphery, the State, businesses, and workers have sufficient power to appropriate for themselves a large portion of value added. Thanks to unions and the welfare State, workers, in particular, are able to obtain much of the product. By contrast, peripheral countries typically have very heterogeneous productive structures, with some high-productivity enclaves that however generate little employment and a very sizable sector of low productivity and underemployment.<sup>8</sup> The weak bargaining power of the State and of workers, who are unskilled and little-organized, combined with a high demographic growth rate, reproduces conditions in which wages remain very low in relative terms. In this manner, the prices of export goods from the center and from

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<sup>6</sup> CEPAL (06/12/12). "Prebisch y Los términos de Intercambio ». (Video File). Findable at: <https://www.youtube.com/watch?v=sqUQQXIdTx8>

<sup>7</sup> CEPAL. *The Balance of Payments as a Constraint on Growth – Raul Prebisch and the challenges for the XXI century*. Findable at: <http://prebisch.cepal.org/en/XXIcentury/balance-payments-constraint-growth>

<sup>8</sup> CEPAL. "Terms of trade – Raul Prebisch and the challenges for the XXI century". Findable at: <http://prebisch.cepal.org/es/sigloXXI/terminos-intercambio>

the periphery reflect very different wage levels. At the end, a better productivity of the Periphery represents in real terms lower prices for the Center buyers and nothing more.

The third important concept of analysis is the Cyclical Movements. Prebisch explains that basic products are much more volatile than manufactured products and so in times of crisis the prices could drop much more causing more damage to the economy. It is indeed important to understand the context in which Prebisch's analysis takes place. The XX century was framed by very impacting events that had strong repercussions in the economy such as the first globalization, the two world wars, and the technological revolution. These events could probably explain the different drops and climbs of the basic product prices.

Concluding with Prebisch's theory, there is this fourth concept of *heterogeneous structures*<sup>9</sup>, which refers to substantial differences between the Periphery and the Center in terms of production systems and the use of technology. This theory explains that there are very asymmetric ways of production in the Periphery, not everybody has the skills and the tools to produce the same good in the more efficient way and so the gains of productivity are not equal. Furthermore, the penetration of technology is much deeper in the Center countries than the rest, meaning a better productivity in all the industries, in all the regions. On the contrary, the Satellites' countries continued to develop with these differences ending with a much more unequal society.

### 2.2.2 Gunter Frank

The next author in the study is the German-American economic historian Andre Gunter Frank. His work in the "Development of the Underdevelopment" (1966) provides clear evidence of the dependency relation between Metropolis and Satellites, as he calls them. Three principal hypotheses emerge from his study:

First, Frank states that the notion of Metropolis and Satellites does not only applies to the relations between developed and underdeveloped countries, he takes this concept further and explains that it also applies for the ties within a particular country. This means that the provincial capitals, which are satellites of the national metropolis and through the latter of the world metropolis, are in turn provincial centers around which their own local satellites orbit. Thus, a whole chain of constellations of metropolis and satellites relates all the cities and communities of the world, from its metropolitan center in Europe or the United States to the farthest outpost in the Latin American countryside.

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<sup>9</sup> CEPAL. "Heterogeneidad Estructural"(Translated from Spanish). Findable at: <http://prebisch.cepal.org/es/sigloXXI/heterogeneidad-estructural>



“Underdevelopment was and still is generated by the very same historical process which also generated economic development: the development of capitalism itself.” (Frank. 1966). The economist suggests that the development that few Latin-American cities experienced in the past did not account for development or wealth for other satellite cities because they accumulate that wealth and capital inside the metropolis. It could be possible to interpret from Frank's work, that the real development of a country occurs when the wealth that arrives at one metropole is used to develop the satellites that surround it.

On the other hand, Frank's hypothesis states that the best moments of industrial development in Latin America were when it was Isolated from the world's Metropolis in times of war or crisis. He illustrates this effect by explaining that during the periods of the two world wars and the great depression countries like Brazil, Mexico, Argentina and Chile experienced the most important recent industrial development. Thanks to the consequent loosening of trade and investment ties during these periods, the satellites initiated marked autonomous industrialization and growth. Frank also refers to a second kind of isolation and explains that regions that were geographically and economically weakly tied to the mercantilist and capitalist system achieved very promising self-generating economic development.

Moreover, the author provides an example at an international level for the same hypothesis. In the words of Frank (1966);

*Internationally, of course, the classic case of industrialization through non-participation as a satellite in the capitalist world system is obviously that of Japan after the Meiji Restoration. Why one may ask, was resource-poor but unsatellized Japan able to industrialize so quickly at the end of the century while resource-rich Latin American countries and Russia were not able to do so and the latter was easily beaten by Japan in the War of 1904 after the same forty years of development efforts? The second hypothesis suggests that the fundamental reason is that Japan was not satellized either during the Tokugawa or the Meiji period and therefore did not have its development structurally limited as did the countries which were so satellized.*

Finally, the third hypothesis derived from Frank's theory and the metropolis-satellite structure is that the regions that are more underdeveloped today, are those that had the closest ties to the metropolis in the past. Numerous examples are given by the author like the West Indies, Northeastern Brazil, the ex-mining districts of Minas Gerais in Brazil, highland Peru, and Bolivia and the central Mexican states of Guanajuato, Zacatecas which were famous by their

silver, or even Bengal in India at the international level. All of these hypotheses suggest that there has been a relevant problem in the inclusion of underdeveloped countries in the capitalist system and that the commercial development model rather than the industrial development, has cost the developing countries many years of economic progress.

### 2.2.3 Henrique Cardoso

Finally in this Dependency School framework, there is the former Marxist intellectual and president of Brazil from 1995 to 2002 Fernando Henrique Cardoso. In his book “Dependency and Development” (1977), the ex-president explains how dependency started in Latin American Countries after the entry into the capitalist system. This theory explains that the situation of “underdevelopment” occurred historically when the expansion of commercial capitalism and then of industrial capitalism linked to the same market economies that, in addition to presenting different degrees of differentiation of the productive system, came to occupy different positions in the global structure of the capitalist system. It is almost like if Latin America would never have the option to not participate in the system, on the contrary, was absorbed by it.

From the economic point of view, Cardoso describes a system as "dependent" when the accumulation and expansion of capital cannot find its essential dynamic component inside the system. In capitalistic economies, the crucial component for the drive to expand is the capacity to enlarge the scale of capital and that cannot be done without the creation of new technologies and continuous expansion of the production of "capital goods". For Latin America, these two factors; technology and capital, came from the outside.

Cardoso's work goes much further in the analysis of dependency and also includes the different kinds of social and political movements that affected the processes of development of each country. Indeed, even if capitalist penetration is a result of external social forces (foreign technology, multinational enterprises, international financial systems etc), it is allowed to happen because there are internal social groups that shared the same foreign interests and values, this is what Cardoso calls “internalization of external interests”<sup>10</sup>. Thus, recognition of the historicity of the situation of underdevelopment requires more than pointing out the structural characteristics of underdeveloped economies. It is necessary to analyze, in effect, how the underdeveloped economies were historically linked to the world market and the way in which these internal social groups were born and linked to the exterior.

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<sup>10</sup> Cardoso. 1971. « *Dependency and Development - PREFACE TO ENGLISH EDITION* ». University of California Press. Berkely.

But before entering in the analysis of this groups it is necessary to make a distinction between too dependency situations that prevail prior to the present system of international capitalism based on the dynamism of multinational corporations: dependency where the productive system was nationally controlled, and dependency in enclave situations.

In enclave economies, foreign invested capital originates in the exterior, is incorporated into local productive processes, and transforms parts of itself into wages and taxes. Its value is increased by the exploitation of local labor forces, which transform nature and produce goods that realize again the life of this capital when staples are sold in the external market.

On the other hand, in economies controlled by the local bourgeoisie, the circuit of capital is formally just the opposite. Accumulation is the result of the appropriation of natural resources by local entrepreneurs and the exploitation of the labor force by this same local group. The Starting point for capital accumulation is thus internal. But even here the international market is required to realize the final steps of the capital circuit (capital accumulation).

Thus, with these two systems being explained, Cardoso makes a historical analysis of the different social groups that born in Latin America in the XX century. Even though there are specific differences between the countries, the general trend of capitalist development had created in most of the countries a powered social group defined as the Oligarchy, which controlled the inflows of external capital and finance, the agro-export sector which was crucial for industrial development but was limited by the downward trend of the terms of trade, the Industrial Bourgeoisie (Middle class) that emerged as a protest against the classical Oligarchy-capitalist class and which plays a relevant role in the "Import Substitution Industrialization", and finally the popular masses divided into rural and urban.

The structural characteristic that emerges in the countries that begin to conform the new economic bases of development consists in the fact that these necessarily imply broad alterations in the social division of labor, which is expressed immediately through the transformation of the demography. All this is reflected in the social level: it engenders a proletariat and increases the popular non-working urban population. In addition, the rate of training of the latter is usually greater than the absorption capacity of the new urban jobs generated by industrialization, and this made possible the formation in Latin America of what was called "mass urban societies", based on Insufficiently industrialized economies (Cardoso 1977).

Class struggles and clashes between these groups defined different ways of development and

industrialization. Consequently, a connection is made that gives meaning to "developmental populism"<sup>11</sup> in which contradictory interests are expressed: expanded consumption-accelerated investments from one side, and state participation in development strengthening of the urban-private sector on the other.

But when the State tried to participate it never achieved prolonged wealth for the working classes, mostly due to external economic factors. Cardoso provides the example of Argentina under Peron's mandate, which was caring redistribution policies in order to reduce the social gap and dignify labor. But his plan was hardly restrained with the end of the "export boom" at the end of World War II which redirect the state to new policies like hold down wages and public expenditures, all at the expense of worker-popular classes.

In the same way, the government of Vargas (1930-1954) in Brazil directed toward a development stimulated by public investment in strategic sectors. However, a drop of prices in coffee seized upon by the United States put pressure on Vargas' nationalist policy and created an angry export-sector opposition.

On the other hand, Mexico who also wanted to act as a distributor of wealth opened at the same time the domestic production to foreign capital. The state occupied a role of regulator of the economy, an urban financial-industrial bourgeoisie was created, and the worker-popular class could participate in development, all of this without oppositions. Nevertheless, the price of this development was the gradual building up of a new kind of oligarchy, which manipulated the state for its own benefit and to advance its scheme of development in association with foreign capital (Cardoso, 1977).

The three cases of Brazil, Mexico, and Argentina were an example of "the developmentalist alliance". Which had as primary objective the substitution of imports, and policies for internal industrialization. These policies encouraged foreign capital to come in and industrialization was based on an urban market. It means that while it intensified the exclusive social system characteristics of capitalism in peripheral communities, it nonetheless promoted capital accumulation and increasing complexity in the production structure.

The import substitution ceased and one of the main causes was the less use of labor, consequence at the same time because of a high-productivity need and the use of new technologies that replaced labor. The dynamism of the modern sector is based on almost

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<sup>11</sup> Cardoso. (1977). « *Dependencia y Desarrollo* ». Siglo XXI editors. Buenos Aires. Findable at: <http://doctoradosociales.com.ar/wp-content/uploads/2016/04/Cardoso-y-Faletto-1970.pdf>

automatic mechanisms. Local industries became dependent on foreign technology and require a continuous expansion. These conditions impeded the government to support older national industries that emerged in the import-substitution period and choose labor-intensive policies of development.

Another big factor of the import substitution stop was indeed the financing methods. During the nationalist-populist period, both national producing groups and the state consolidated centers of production. However, a development path was settled that depended on increasing amounts of foreign investment in the industrial sector. External financing in Latin America made it clear that foreign investment was increasingly directed to the manufacturing sector through private investment, with direct investment predominating over portfolio investment, and that it operated through a very small number of firms.<sup>12</sup> Consequently, even if the levels of development may have seemed very high, both capital flow and economic decisions were controlled from abroad.

The fact that most of the earnings of this industrialization process go to the center countries does not allow reinvestment to happen. Moreover, industrialization in the periphery requires a vast capital input, technological knowledge, and a highly skilled managerial organization, the fact that the central nations have these available tightens the bonds of dependence. Latin America brought all of these requirements from the outside at the expense of autonomy of the national economic system and of policy decisions for development.

On the other hand, there are examples of underdeveloped nations that succeeded to avoid the dependency ties. Cardoso (1977) explains that when development and autonomy are achieved simultaneously, resources and economic activity could transform the production system successfully and that was possible because of political conditions. The Soviet Union or China went through a period of relative economic isolation when the markets were partially closed and the pressures to expand consumption were blocked. That allowed the state to have control over the production system and to redirect investments to strategic sectors focused on national development, like infrastructure or advanced technology. The same policies were adopted by Japan even when a capitalist regime was maintained.

To conclude its study, Cardoso encourages implicitly to the opposition of these regimes of development which constraint the wealth of Latin American countries and says that there are "structural possibilities for various types of social and political movements"<sup>13</sup>. The change is,

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<sup>12</sup> Cf. ECLA. 1964. *"El Financiamiento Externo de America Latina"*. New York: United Nations.

<sup>13</sup> Cardoso. (1977). *«Dependencia y Desarrollo»*. Siglo XXI editors. Buenos Aires. Findable at: <http://doctoradosociales.com.ar/wp-content/uploads/2016/04/Cardoso-y-Faletto-1970.pdf>

therefore, possible under collective action guided by political wills, this last point is one of the few that would remain alive in Cardoso's new thinking.

*The change of thinking:*

Fernando Henrique Cardoso published the first edition of “Dependence and Development” in 1964 and since then until its arrival to the Brazilian presidency, he changes his thinking about several of the points that were vital for its study of dependency. In fact, as president, he started a neo-liberal plan in which direct foreign investments flowed in and state’s companies were sold to the private sector. As a result, Brazil achieved to control the hyperinflation of the 1980s and started a stable process of growth and industrialization.<sup>14</sup>

So the Cardoso of the 1970s was very different from the one that took control of the presidential house in 1995. The liberal ideas started entering in Cardoso’s head when he sited as a senator twelve years before becoming president, explains Robert Packenham, professor of political science at the University of Stanford California in an interview with the journal “A Folha de Sao Paulo”.<sup>15</sup> Packenham stated that the ideas of the Dependency School, which Cardoso supported, did not bring any real solutions for Latin American problems, everything was very utopic and so the change of thinking was a signal of maturity.

Cardoso himself admits that his change of mind was a result of a lot of research and that his work on dependency was very influenced by Marx.<sup>16</sup> Indeed, he says that what triggered his change was the study of the Nordic Countries.

*“Where has there been more balance between production and consumption (distribution)? In the Nordic countries, which are social democrats. It is just that banal, but that is it. In the end, that is why I am a social democrat. And why I have supported the third way. It is not because of adhesion to I-don't-know-what... It is because otherwise, you have savage capitalism, simply because in its essence that is how it works. So you need political forces that hold it back. That is where democracy comes in.” (Cardoso, 2013)*

Cardoso still remains quite Marxist in regard to capitalism, because he believes it would never

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<sup>14</sup> Scissors Derek. (2012). “Brazil: Restoring Economic Growth Through Economic Freedom”. The Heritage Foundation. Findable at: [http://www.heritage.org/americas/report/brazil-restoring-economic-growth-through-economic-freedom#\\_fn10](http://www.heritage.org/americas/report/brazil-restoring-economic-growth-through-economic-freedom#_fn10)

<sup>15</sup> Falcao Daniela. 1995. « Presidente Agora Esta Mais Realista ». Folha de Sao Paulo. Brasil. Findable at: <http://www1.folha.uol.com.br/fsp/1995/7/23/brasil/14.html>

<sup>16</sup> Lima Pedro Luiz. 2013. “Interview with Fernando Henrique Cardoso”. Revista Estudos Politicos. Rio de Janeiro. Findable at: <http://revistaestudospoliticos.com/wp-content/uploads/2013/10/6p22-36.pdf>

bring equilibrium, in fact, it lacks equilibrium historically. Therefore, there are necessary forms of global governance to counteract the inherent irrationality of capitalism, and there is where politics take place, and that is why politics are so important.

It is possible to infer from Cardoso's transformation that what happened to his thinking was, in fact, the acceptance of the inevitability of capitalism and globalization, that there is no pacific way to escape it, and that the only viable option is to adapt and basically try to make the best out of it.

### 2.3 American Power and The New International Economic Order

Now that the theories of the Dependency School have been exposed, it is crucial for this paper to include the history of the other side of the relation of dependency, the center. The last fragment of the literature review will include a historical analysis of United State's hegemony in the XX century, the institutions built to concentrate power, the international economic environment during the post-war period and the foundation of the New International Economic Order.

After the Second World War, the world will experience the most impressive expansion of the capitalist system in history. The outcome of the war reshaped the balance of power in world politics. It undermined the empires of Britain, France, Belgium, Italy, and Netherlands, it temporarily reduced the power of the main axis states – Germany Italy and Japan, it massively increased the power of the main military rivals to Hitler's Germany – Stalin's Soviet Union and above all, Roosevelt's USA. (Bromley 2008). Indeed, all European powers thought that the financial leadership and military protection of the United States will bring economic stability after the war and for that reason they avoided competition of currencies, did not create protectionist tariffs, subsidies of exports or any other kind of measure that would prevent United States economic development. (Hudson, 2003; 8). So Europe became a satellite of the American Power as well.

The modernization of the agricultural and industrial sectors in the American country permitted very high levels of productivity and a thus a large quantity of goods with insufficient local demand for them. Hence, the new world's power found a solution in the international market, and intensely promote a “free trade” and “open market” global economy, it was the start of the period known as “Laissez Faire”. By 1950 the United States had achieved \$10 billion in annual exports and had 72% of the world's gold's reserves. (Hudson 2003; 13).



Ironically, a double standard was maintained during the “Laissez Faire” period when it came to protection measures because at the same time the United States promoted free trade and open doors to world investment it built strong protectionist policies for their agriculture, steel, textiles and electronics’ sectors. (Hudson 2003; 14). American’s government created quotas to limit the entry of foreign goods to the country in a clear violation of all the principals of the GATT (General Agreement on Tariffs and Trade) but as they were the founders of the institution the other members had poor chances to confront the situation.

However, American’s balance of payments surplus did not last forever. The costs of the Cold War were big, and with the Korea’s war and Vietnam military intervention the United States saw their balance go to deficit, and one major problem rose from that deficit, more for the world than for the United States themselves. Because no mechanism was built to curtail U.S dollar creation beyond a given point, nor was much thought given to the prospect of an overabundance of dollar liquidity, the world was automatically introduced into a "dollar dependent" regime. The refusal of the dollars would devalue the currency making American’s product prices drop and hence becoming much more competitive (Hudson, 2003; 23), that meant the other countries were at the mercy of the dollar.

Consequently, USA developed a financial strategy that permitted it to run its deficit without struggle. As the deficit keep increasing, the American power found itself without enough gold to back up their debt and ended up abandoning the gold standard in 1971. Now, they would give out dollars which could only be reinvested in USA Treasury Bills. In that way, the capital that shipped abroad was reinserted to the economy by the foreign central banks. By 1973 foreign banks have financed \$52 billion of new federal debt (Hudson, 2003; 26). At the same time, as there was an overabundance of dollars, the whole world was experiencing high inflation, which the interest on USA’s promissory notes did not cover.

The 1970s were a decade of lots of economic struggle that would generate new ways of economic thinking and policies. In the first place, the OPEC which was created in 1960 and has not had enough importance decided to cut the production of oil in 1973, quadrupling the prices of the barrel (Hudson 2003; 59). The first reaction of the United States was to hold up food embargoes to put pressure on Europe and other Third World countries for lowering oil prices. The OPEC resist and allied with Europe, and the United States once again used its treasury bill standard to convince the OPEC countries in investing in America. Treasury bill holdings were transferred from Europe and Japan to OPEC, which meant that the USA protected itself from any oil prices changes as the petrodollars could always come back to them. (Hudson 2003; 110). Nevertheless, the increasing income of the OPEC countries did not permit them to buy any



companies in the USA, indeed, all the industrial countries were reluctant to let the petroleum producers buy shares but especially the USA which created a legislation that prevented hostile takeovers from Arab investors, and even restrains the possibility of acquiring more than 5% of a company (Hudson 2003; 117).

### 2.3.1 The New International Economic Order

After almost three decades of a capitalist post-war order, the countries of the Third World join forces and raise the voice against the abuse of the United States over the rest. The world had enough of American's double standard, encouraging free trade but raising up quotas for imports, encouraging open doors for investment and creating barriers for foreign investors, running foreign aid programs but with the objective of developing the export sector of their targets to make raw material prices lower. The French president Giscard d'Estaing claimed in Zaire:

*"The rules and balances on which the old economic order was built cannot and, what is more, should not be restored in their existing form. Equilibrating means returning to situations of equilibrium that should themselves result in the implementation of a procedure for limited adjustments". (Giscard d'Estaing 1975)*

Thus, a primary goal for the New International Economic Order was to constraint any single nation or region from unilaterally exploiting others. The new principals for the economy included (Hudson 2003; 173):

- World economy regulated by governments acting in their national self-interest.
- Industrial imports increasingly regulated by quota agreements based on fixed market shares.
- Governments regulate foreign investments and control their own resources.
- Third World exports priced at their high-cost margin and traded for technology and equipment to produce essentials.
- Multinationals are bought out or taxed, transferring profits to host countries.
- Trade imbalance between regions settled in gold or stock in private firms.

But as it was expected, the industrial nations and especially the United States, which thought that the world economy should remain controlled by multinationals, opposed the Third World goals for two major reasons. First, higher raw-materials prices will disturb their balance of

payments or require greater transfer of exports (or sale of their own industrial firms) to Third World countries. And second, the development of domestic Third World agriculture and industry will bring new direct competition for the exporters of the industrial nations.

Consequently, the NIEO program did not succeed and was indeed replaced by the Washington consensus. Its optimism has been replaced by the financial austerity and privatizations imposed by the World Bank and International Monetary Fund (IMF) since the 1980s after Margaret Thatcher was elected Prime Minister of Britain in 1979 and Ronald Reagan won the American presidential election a year later.<sup>17</sup>

The Washington Consensus was created in 1989 by a World Bank economist, John Williamson, as a response to the collapse in the prices of Third World bonds and bank loans after Mexico's default in 1982 triggered the Latin American "debt bomb." The new economic program included points like:<sup>18</sup>

- Fiscal discipline
- A redirection of public expenditure priorities toward fields offering both high economic returns and the potential to improve income distribution, such as primary health care, primary education, and infrastructure
- Tax reform (to lower marginal rates and broaden the tax base)
- Interest rate liberalization
- A competitive exchange rate
- Trade liberalization
- Liberalization of inflows of foreign direct investment
- Privatization
- Deregulation (to abolish barriers to entry and exit)
- Secure property rights

Under these policies, the 1980s saw the World Bank and IMF use their creditor leverage to impose an era of privatization that dismantled and sold off public enterprises and social infrastructure, leaving economies much further indebted and more foreign-owned than anyone imagined in the 1970s.

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<sup>17</sup> Hudson, 2003. "Introduction to Global Fracture". University of Michigan Press. Findable at: <http://michael-hudson.com/books/global-fracture-the-new-international-economic-order/>

<sup>18</sup> Center for International Development. 2003. "Washington Consensus". University of Harvard. Findable at: <http://www.cid.harvard.edu/cidtrade/issues/washington.html>

*“Mixed with mismanagement and corrupt governance, the Washington Consensus managed to undermine a dozen economies in a decade. Countries like Argentina and Indonesia found that the speed and greed of modern finance was a pipeline for every sort of instability.”<sup>19</sup>*

To conclude, the United States, the architects of that earlier system built institutions such as the IMF and the GATT, designed to respond to the lessons of the Depression and the war. (Kirshner 2014; 4), created and promoted a capitalist economic system that absorbed the world's wealth on brought it to them. The financial sector and debt were used as tools for building up ties of dependency with the rest of the world. And the Third World which wants to see development and industrialization keeps fighting with the Center countries that seem to see as “normal” every trade agreement, or investment that brings more wealth for them than for the poor.

#### 2.4 Correlation of the literature

After studying the subject from different perspectives it is interesting to notice that even if the ties of dependency are mostly due to the expansion of capitalism under specific circumstances, a lot of the actions that conducted that expansion were done intentionally by the governments of the Center, most important of the United States. And that realization opens indeed, the doors to the debate on whether Capitalism is uncontrollable or not. Because in the same way, the United States drove policies to capitalized the world there should be feasible actions to control the most hindering points of the system.

Another conclusion of the observation of the sources is the vital role that occupied the internal forces in the Satellites in the absorption of the capitalist system. Cardoso did do a brilliant discovery when he talked about the internalization of external interests as simple as this could be. Because no capitalist development could have been possible if it was not allowed by internal influential individuals in the Third World that saw a better deal in profiting from scale production and easy finance at the costs of their own country's economy. This factor is easily identifiable when the United States promoted free trade and everybody increased the extraction of raw materials, or when they offered easy loans during the seventies, it is clear that a little group of people profited from those offers, and that probably without its existence history could have been different.

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<sup>19</sup> Cooper Ramos Joshua, 2004. “China has discovered its own economic consensus,” *Financial Times* (London),

On the other hand, it is very interesting to see how Frank's theory on the chain of Metropolis and Satellites and Prebisch theory on heterogeneity are related to Cardoso's analyses of Latin American societies. Cardoso explains how different groups emerged from globalization, the Oligarchy, the agro-export sector, the Industrial Bourgeoisie, the popular masses etc. And comments how the ideologies of these groups clashed against the others and restrain development. In fact, this lack of cooperation within the societies in developing countries, this diversification of interests, this disparity of opportunities and ideologies combined with poor government and corruption were major barriers in the finding of a wealthy path towards development.

To sum up this analysis of the literature, I highlight the fact that there are External and Internal factors in the development of dependency, and that without the latest the history of capital expansion would not have been the same. It is the obligation of the societies of the Third World to realize that the alternatives must arise first from them in order to make the changes they need.

### 3. GLOBAL ECONOMY AND CONTEMPORARY TRENDS OF DEPENDENCY

The following fragment of this paper will be separated into two parts. The first one will be focused on the study of actual trends of international trade; the global trends in exports and imports, the structure of production, and the impact of those in the economy. The second part will focus on the flow of capital in the forms of debt or investment. As broad as this study could seem, general indicators and trends could tell a lot if analyzed correctly. It is important to highlight that during all this research I will adopt a Dependency School view, distinguishing constantly Center countries from Peripheral countries for proving the existence of actual ties of dependency.

#### 3.1 Dependency on International Trade

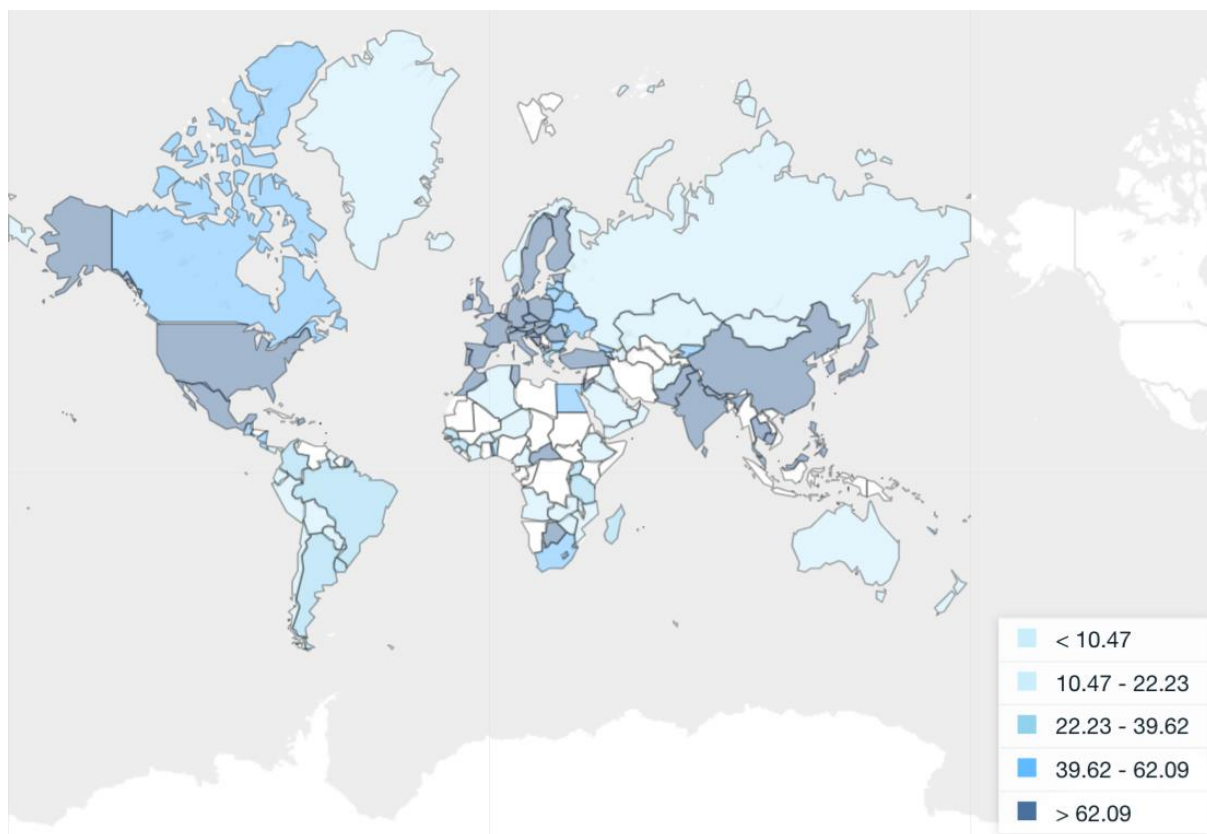
Following the Dependency School theories, the first sign of dependency appears when a country has to import most of the goods that are required for industrialization and development, i.e. manufactured goods, medicines, and technology. These kind of goods are the ones that ensure better health and better education which represent better jobs and therefore better standards of living. To some extent, the need for these kinds of products could be relativized because of social and cultural differences, but globalization has imposed some standards of leaving that reject those factors.

Ever since the beginning of the XX century, the world has experienced an exponential rise in the number of international transactions of goods, services, and capital that has never been seen before. All that due to the advance in technologies that have encouraged the communication between nations and their population. And because of changes in the legislation that have motivated nations to go outside their territory for feed their needs (or create new ones).

Developing countries have been participating actively in this whole set of transactions in an effort to grow their economies. However, the international scenario of trade has not been the best place for those countries to make a profit. On the contrary, the Third World feels that it has been giving up its natural resources and labor force at a very low price and at the expense of rapid development. The disparities between the Centers and the Satellites in production are remarkable because the whole process has conditioned the developing world to wait for foreign

technology to improve productivity and industrialize.

## Manufactures exports (% of merchandise exports) (Map 1)



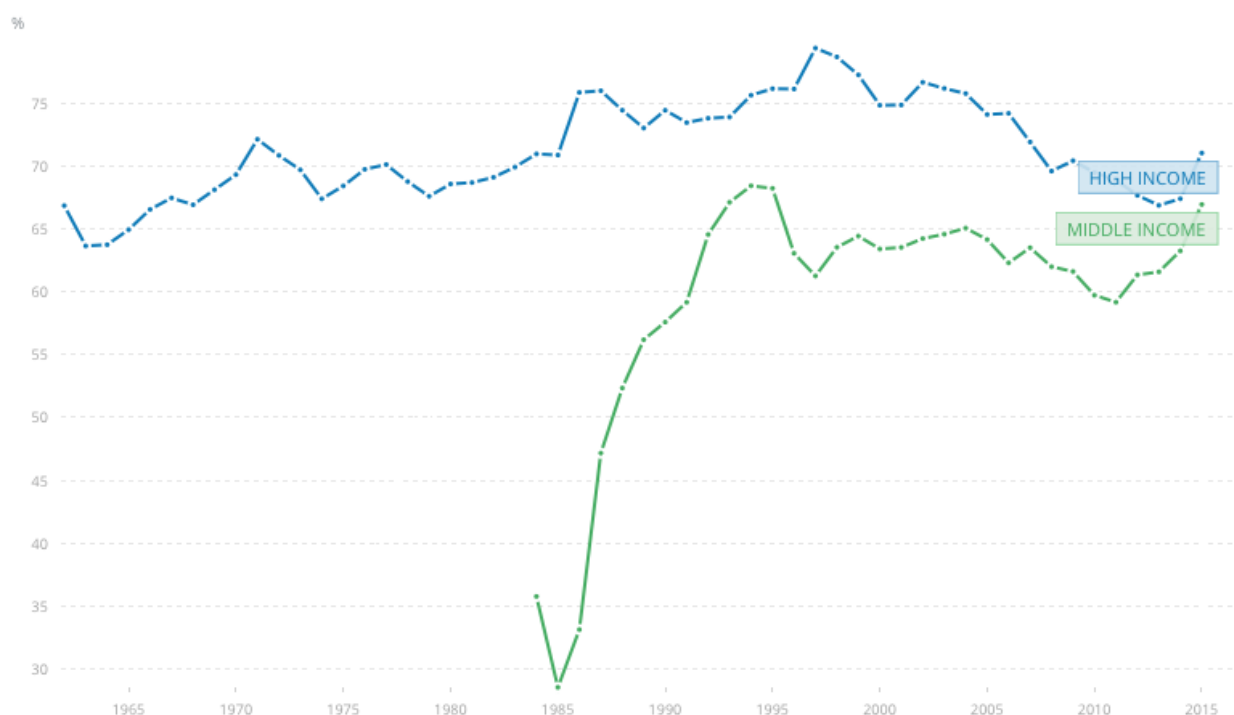
Source: World Bank by the United Nations Statistics Division.

Breaking down the process of trade, it is inferable that if a country is able to export manufactured and technological goods, it means that it already has the technology and skilled labor required for the production. As we can see in Map 1, the countries that account for manufactured goods exporters are considerably fewer than the rest. Latin America, Russia, almost all Africa's exports are based on primary commodities with lower value added. In turn, this makes it very difficult for the working class of these regions to purchase value added products; how many kilos of coffee should produce a Colombian farmer to afford a TV? how many bananas should collect a family in Ivory Coast before they can buy medicine?

Until this point and only by looking at this map it could be said that dependency still exists between the Center Countries and the Satellites. However, this map leaves out some important

questions like what percentage of manufacture goods is produced for developing countries and stays in the country? Is the trend of manufactured goods production increasing or decreasing in developing countries? To what extent do developed countries need raw materials from developing countries to produce their manufactured goods?

## Manufactures exports (% of merchandise exports) (Figure 1)

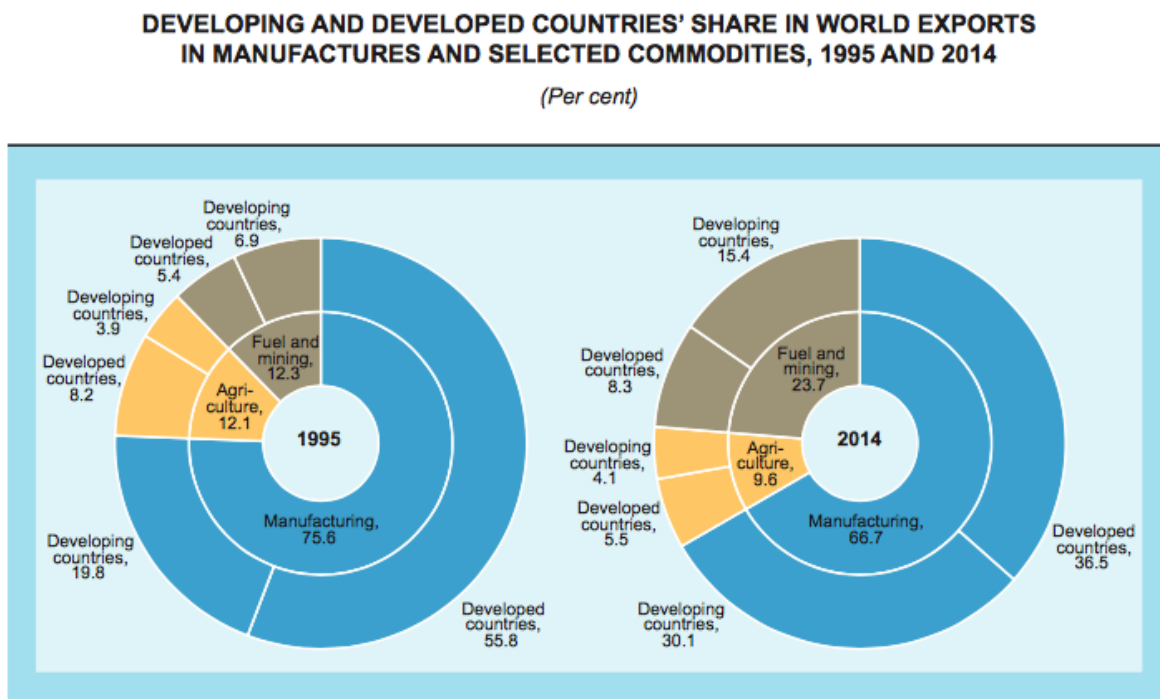


Source: Data World Bank

If we take the historical view of the Chart 1 the forecast is more uplifting. Third World countries achieved a very important development of the manufacturing sector in 1980 after the boom of oil prices which definitely boost the economies of the oil exporters. It has definitely been an evolution in the industries of the Satellites. The agricultural, mining and manufacture sector have been developed as it could be seen in Figure 2. Manufacture, for example, had a growth of 57% in almost 20 years. The mining and oil industry expanded at the cost of environmental stability thanks to new technology and methods of extraction such as fracking.<sup>20</sup>

<sup>20</sup> BBC News. 2015. "What is fracking and why is it controversial?" .United Kingdom

Figure 2



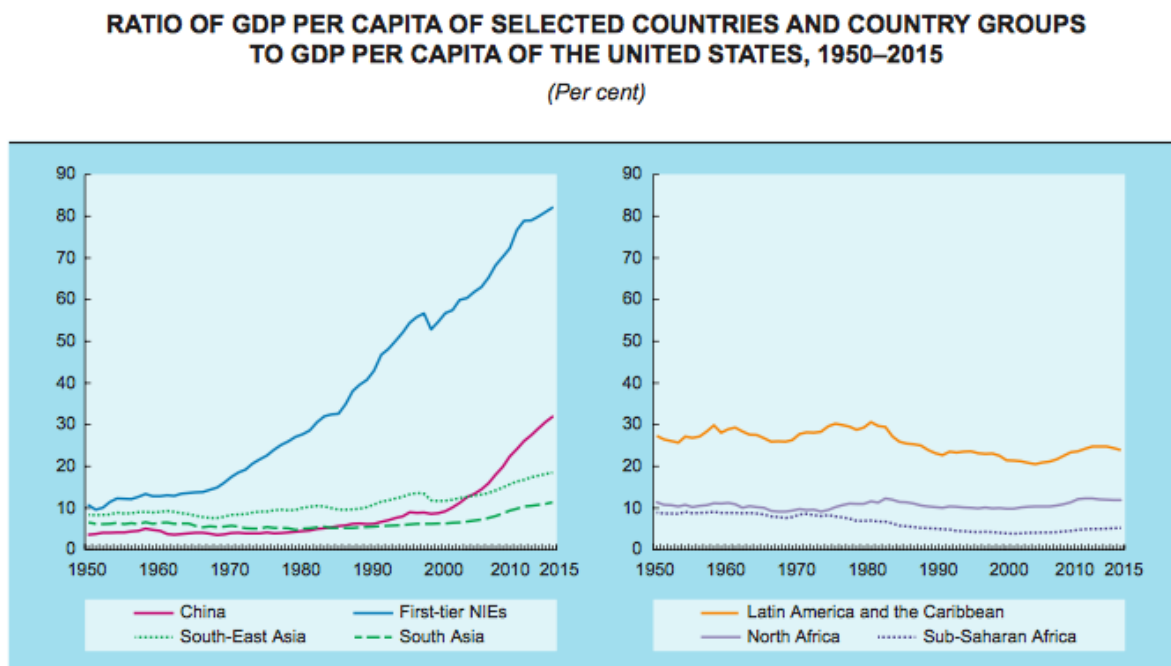
**Source:** UNCTAD secretariat calculations, based on *UNCTADstat*.

However, even if these indicators show a positive trend, they could not yet be accountable for real development and higher living standards for the people of the Periphery. In fact, they could be misleading and be taken as a positive sign of the “free trade” capitalist system. Some questions remain unclear as how owns the manufacture industries of the Third World? How indebted is the industry and how much is dependent on foreign capital?

What is actually very clear is that the periphery has been making a big effort to develop its economy through the same international trade policies that came along with the capitalist system at the beginning of the XX century and have been loudly promoted for the center countries. And despite the increasing participation in global trade, developing countries are far away from reaching the level of life that center countries enjoy nowadays. Only the “Asian Tigers” or NIEs have achieved similar incomes per capita in comparison to the United States (see Figure 3) Latin America, Africa, and South Asia show very little improvement. Only China registers a clear positive trend that has significantly started since the year 2000.



Figure 3



**Source:** UNCTAD secretariat calculations, based on The Conference Board, *Total Economy Database*, May 2015.

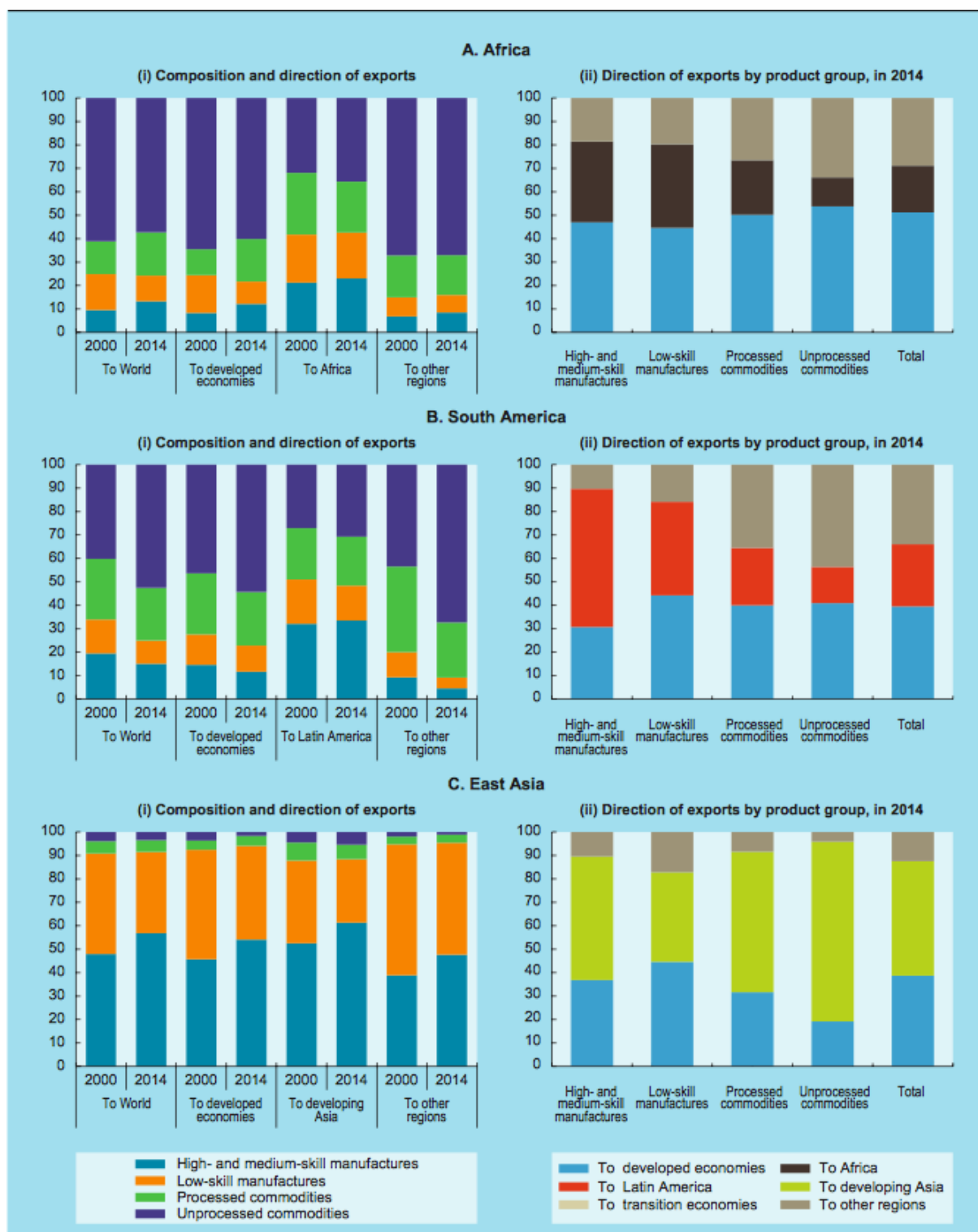
**Note:** First-tier newly industrializing economies (NIEs) are Hong Kong (China), the Republic of Korea, Singapore and Taiwan Province of China.

Consequently, there is a contradiction in the amount of output that developing countries is producing and the wealth reflected in their economies. It is very complicated to define the specific problematics that Third World countries have to develop their economies because many factors can influence this development. Corporate governance, disposition of natural resources, war, political ideologies, history, number of population and even religion could make this study much more complex.

But even with the complexity of the situation, indicators of production and a general understanding of geopolitics, it could be possible to determine actual economic positions. The Figure 4 show the percentage of the different kinds of goods produced by regions and it definitely changes the perception of the chart before (Figure 2). In fact, the evolution of the manufacturing industry was much stronger in East Asia than anywhere else. Latin America and Africa base their economies mainly in unprocessed commodities. Therefore, the huge boom of manufactured exports of developing countries is mainly due to the China's industrialization that started 35 years ago, along with the Indian's that arrived a little later. This could partially explain why the rest of the satellites have not experienced a proportional improvement in their GDP per capita.

## COMPOSITION AND DIRECTION OF EXPORTS, SELECTED REGIONS/GROUPS, 2000–2014 (Figure 4)

(Per cent)

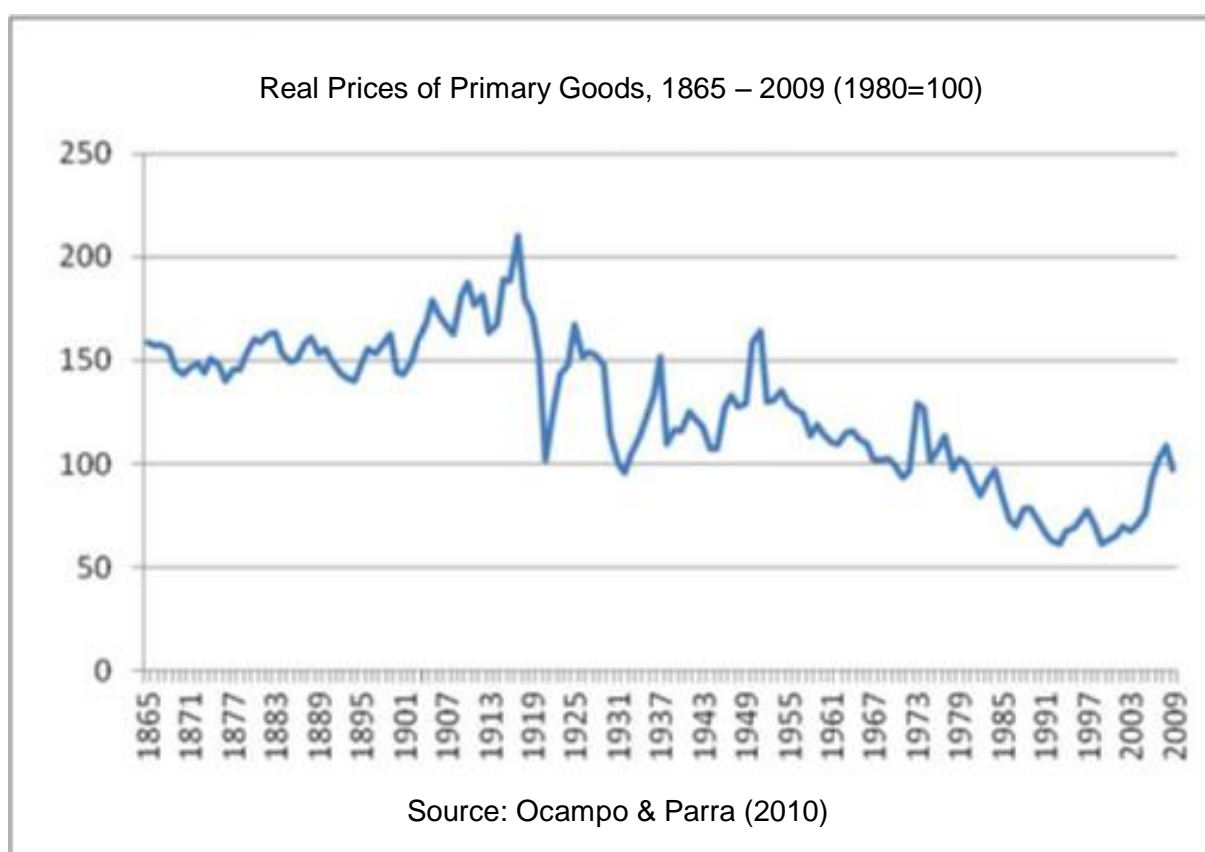


Source: UNCTAD Secretariat calculations, based on UNCTAD stat

Evidently, there is a mayor factor in the development of this region, the demographics; Asia currently has 60% of the world population. To ensure enough employment for their people, China decided to open their doors to foreign investment and become the fabric of the world. But this, in turn, has shrunk China's natural resources and make them dependent on global demand, even though they are trying to develop a local demand its economy still relies on western markets and it will take a long time before that changes. The rest of the developing countries have shown some improvement in the manufacturing industry but at a much lower scale, North Africa, Latin America and the Caribbean, and South Asia (without India) show positive trends in manufactured exports that could continue under good governance.<sup>21</sup>

For the moment, the main source of income for the rest of developing countries is the export of primary commodities which prices have been declining showing also very high volatility, see Figure 5. Prebisch theories on economic cycles and income elasticity could be proven with the prices of primary goods that have not follow a stable trend. Consequently, the agriculture sector was the most affected by world crises. This Chart also allows seeing how the GATT since its creation in 1947 never provides solutions for the decreasing terms of trade.

Figure 5



<sup>21</sup> World Bank Data. 2016. "Manufacture Exports % of merchandise exports". Findable at: <http://data.worldbank.org/indicator/TX.VAL.MANF.ZS.UN?end=2014&locations=XN-ZJ-8S-ZQ&start=1962&view=chart>

The development of the manufacturing industry could set the basis for development in the Third World but must be accompanied by an improvement in the terms of trade, and by a spread of the profits into different kinds of sub-industries and sub-regions which could only be achieved through the participation of the government. Frank's theory (1966) of the Satellites of the Satellites is crucial for understanding the barriers to development. No matter what are the evolutions in the terms of trade or the manufacturing industry, if the profits are accumulated for one little portion of the population, then growth in GDP or exports do not represent any improvement for the society as a whole. The flows of population could be very representative for the analysis of this particular subject because they illustrate the "centers" of accumulation and thus, the points of dependency. For a fact, urban population growth is twice as big in middle-income countries than high income.<sup>22</sup> It means that the rural population is traveling from the countryside and the villages to the cities looking for higher standards of living that can not be found in there, that is, without a doubt, a clear signal of internal dependency.

Furthermore, if we analyze the phenomenon at global levels, we found too that there is a significant shift of labor force that goes from developing countries to the "Center". Net migration, - the number of migrants arriving in OECD countries minus those leaving, - reached almost three million migrants on average over the period 1987 to 2009.<sup>23</sup> So the urban centers attract labor forces from the satellites because it offers better wages than the rural, consequently, the urban conglomerates develop industry and technology but do not transfer these to the rural that suffers from lower prices for their products and indeed lower wages. And for the middle-income countries still, half of the population lives in the countryside, which means poverty is much broad than in the center. If the trend continues a big question arises; who is going to produce the food in the future?

And this problematic does not only concerns developing countries but the industrialized world too. Europe has been showing a decline in the wages of farmers for the last years and the governments start questioning if the policies of free trade created by the European Union commission are in fact destroying the local industry.<sup>24</sup> In the absence of concerted recoveries in the developed economies, international trade is in the doldrums for the fifth straight year. To date, protectionist tendencies have been kept in check, but risk surfacing if the real causes of this slowdown are not tackled effectively. The major problem is weak global demand due

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<sup>22</sup> World Bank Data. 2016. "Urban population growth (annual %)". Findable at: <http://data.worldbank.org/indicator/SP.URB.GROW?locations=XD-XP-1W>

<sup>23</sup> Ekrame Boubtane, Dramane Coulibaly, Christophe Rault. *Immigration, growth, and unemployment: Panel VAR evidence from OECD countries. Documents de travail du Centre d'Economie de la Sorbonne 2013.12 - ISSN: 1955-611X. 2013. Findable at: <https://halshs.archives-ouvertes.fr/halshs-00800608/document>*

<sup>24</sup> Eric de La Chesnais. 2016. "Les Huit Raisons du Déclin de l'Agriculture française". *Journal Le Figaro Economic*.

largely to stagnant real wages.

Governments in the Center countries have started to question the policies of “free trade” that exist in the actuality because they feel these are threatening the local producers. And to some extent, it has harmed local producers because manufactures produced in developing countries are cheaper. And the reasons for that are the same as those that were identified as causing the decline in the terms of trade of primary commodities vis-à-vis those of manufacturers: different labor market conditions and the existence of abundant and unorganized low- skilled labor. This implies that productivity gains are to a large extent reflected in lower prices and that wages in the developing countries tend to be more flexible than in developed countries. Moreover, many middle-income countries start to feel that they can no longer compete in the production of low-wage commodities, and at the same time, they have not developed the capabilities to compete on a broad basis in higher productivity activities. Satellite countries now are endangered of being trapped, of being pushed onto the low road to development, where declining wages form the basis for competitiveness and growth.

This opens another debate, what is the real impact of free trade in developing and developed countries. The most radical opposition to free trade argues that it causes job destruction in the developed countries because the warehouses are transferred to lower wages countries. That accounts for more jobs in the developing countries but not necessarily better paid. The big winners of the trade are the multinationals that get the gains of both bigger markets and lower costs. And this is possible because there are some specific forces in developing countries that attract those multinationals. Once again, the "internalization of external interests" is one of the major factors of the inability of the Third World to distribute the wealth that brings work and resources. If free trade was as positive for the world as Milton Friedman and the liberal economies claim it would not be that controversial. History and data show that there is always and unbalanced result in the outcomes of such agreements, there is always a winner and a loser or a better winner.

### 3.2 Dependency on Finance

This second part of the research will study the ties of dependency created by the financial sector and it is as much as important as the previous. It will analyze the actual situation regarding national debt and the relevance of foreign capital in developing countries. It will also comment on the transformation of the financial sector and the new models that affect directly the economic development of all the world. Although the Dependency School failed in studying the effects of foreign investment or capital flows, its principals could be applicable and helpful for understanding those.

The first factor of dependency that arises when talking about capital is debt. Debt is one of the strongest forms of control that could exist between countries and probably the most common in the modern era. The country that owns the debt of another could obligate the borrower to follow policies that restrain its economic development in order to ensure the repayment of the debt and the interest. International financial institutions like the World Bank or the FMI are in charge of putting those pressures to governments in debt. Many examples are available on this: the actual austerity program led by Europe and imposed by the European Central Bank that restrains public spending and punishes the economies, or the austerity program that drove Latin America through negative growth and hyperinflation during the 1980s imposed by the IMF after the Washington Consensus.

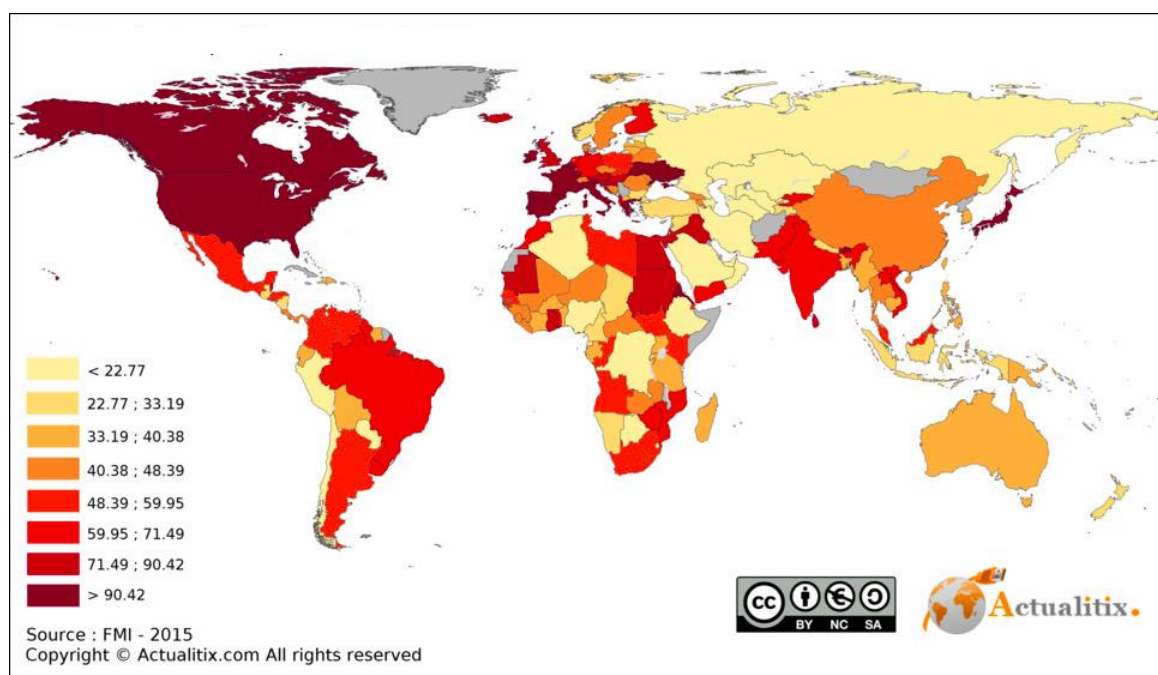
Nevertheless, debt could also be very threatening for the lenders, especially when the amounts of money are high. The old bank premise says, “If a person owes \$5000 to the bank that he cannot pay he’s in trouble, if he owes \$50 million then the Bank is in trouble”. There are also various examples that prove this: The private banking sector of the United States struggled after Mexico defaulted in 1982 and now the German banks are concerned with the Greek crisis that could cost them billions of euros.

So, debt is a double side coin, it could be great for boosting development and industrialization and on the other side could be the noose around the neck that impedes economic policy and maintains crisis. It could result as a great investment or it could threat the stability of the financial sector for a whole country.

The actual situation of world’s debt is very interesting because it illustrates current economic tendencies that seem unsustainable. Map 2 present the Public Debt as % of GDP and it could be astonishing to see that the most developed countries are the ones that run the higher public debts. However, this is explainable for various reasons.



Map 2: Public debt as % of GDP



Source: FMI,

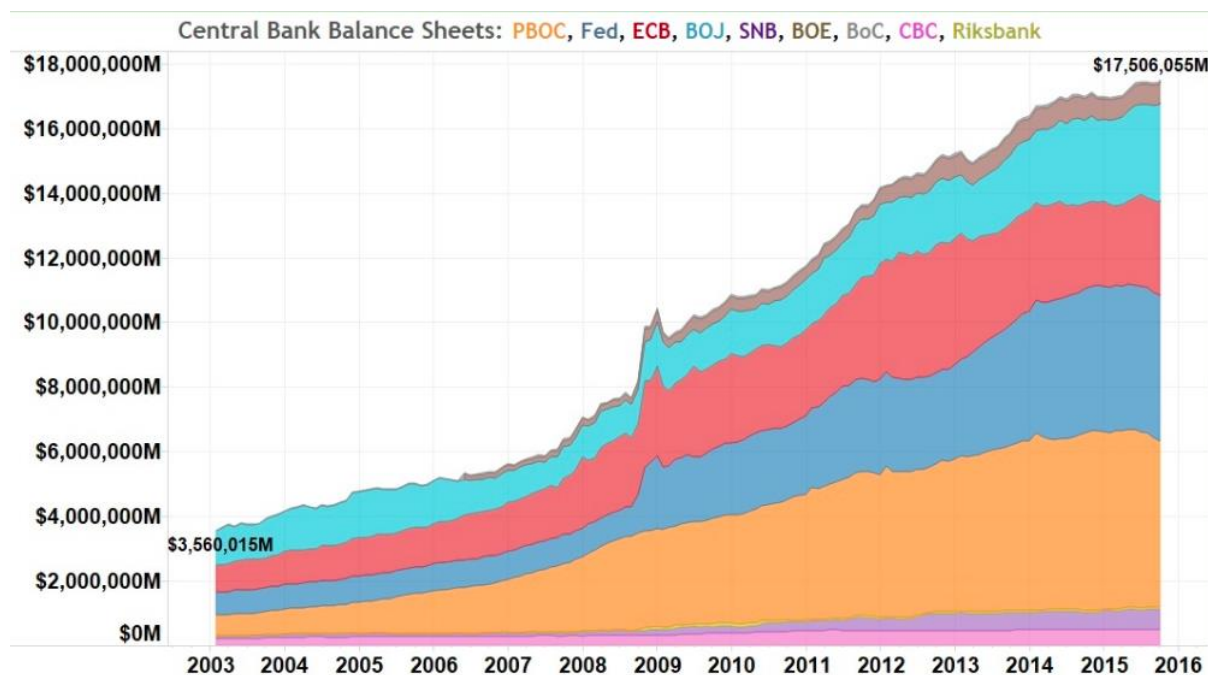
The first reason of high national debt in developed economies is very simple, is because they are able to borrow easily. Because of their economic strength, international investors do not doubt in buying treasury notes from those governments because the risk is supposed to be very low, of course, if that changes and people lose confidence in the government's interest rates could rise and it could be catastrophic for those countries. Secondly, at the same time, those countries run debt, they also own the debt of others, for example, the United States have a current debt of \$19 trillion, and at the same time, the value of foreign holdings of U.S. securities was \$17 trillion in 2016.<sup>25</sup> In fact, a big chunk of the National Debt of the USA is own by institutions within the country like the Federal Reserve or the Social Security Trust Fund (Pension Fund). So, where is the money for credit coming from? From thin air.

Quantitative easing has been one of the most popular actions of the richer central banks of the world. It is the art of creating money out of nothing and as wonderful as it could appear it is in

<sup>25</sup> U.S Department of Treasury. "PRELIMINARY REPORT ON FOREIGN PORTFOLIO HOLDINGS OF U.S. SECURITIES AT END-JUNE 2016. Press Release, 2017. Washington. Findable at: <http://ticdata.treasury.gov/Publish/shlprelim.html>

fact very dangerous. This monetary policy is possible nowadays because there are no real physical assets necessary to backup money. The central banks embarked in Quantitative Easing after the 2008 financial crisis and have not stopped yet, they “print “ new money to buy treasury bonds through commercial banks and that is how governments finance the public debt. Figure 6 exhibits the exponential growth in assets of the main central banks of the world.

Figure 6



Source: National Inflation Association USA. (2016)

Central Bank Abbreviations: PBOC: People's Bank of China, Fed: Federal Reserve, ECB: European Central Bank, BOJ: Bank of Japan, SNB: Swiss National Bank, BOE: Bank of England, BoC: Bank of Canada, CBC: Central Bank of Taiwan, Riksbank: Swedish National Bank

Although quantitative easing helped to sustain employment after the financial crisis, it could be very dangerous if kept as a common monetary policy. The real risk is hyperinflation, if more and more money is inserted to the economy from a moment to another then it loses its value, the only way to create real value is with people that go to work and produces that value. The first that benefit from QE are the banks and government that obtain the money first, then the rich families and powerful companies that watch the prices of stock and bonds go up and finally the rest of the people, however the first to suffer the consequences of inflation are these last, the working class, the poor, who experience in the real live the rise of prices.

Moreover, what results interesting of quantitative easing is precisely how easy the developed countries can finance debt, especially the United States. The world power ran a \$45Bn trade



deficit and a total current account deficit of \$481Bn in 2016<sup>26</sup>. And that is possible because of the world trust that USA economy is strong enough to repay back all the money it owes, it trusts the stability of their institutions and the value of their currency. And that “trust” is precisely and ironically another point of dependency. More than 60% of the currency reserves of the world are in dollars<sup>27</sup>, more dollars are trading outside the United States than inside, and that means that if the USA economy collapses, those dollars will lose worth and thus the whole world will struggle.

On the other hand, there has been growing concern about financial fragility in peripheral economies due to a flood of financial flows and cheap credit since 2009, fueled to a large extent by the quantitative easing programs exposed before. The exploding corporate debt incurred by emerging market economies is also alarming. According to the Bank for International Settlements, non-financial corporations' debt in these economies increased from about \$ 9 trillion at the end of 2008 to just over \$ 25 trillion by the end of 2015 and doubled as a percentage of the domestic product Gross) - from 57 per cent to 104 per cent - over the same period<sup>28</sup>.

History has shown that debt has not been the most profitable product for developing countries. A clear example is the Financial Aid program of the United States that lead to massive indebtedness in Latin America, full their hands with foreign savings and after drained all the liquidity of the region in the eighties. Or the Greek debt crisis that has drowned the country in deep recession. On the contrary, the countries that best have succeeded are those that did not use foreign finance.

*“In the 1980s the six original NICs fell apart; but while the four Asian tigers continued to grow fast, and today 36 years later, are already rich countries, Brazil and Mexico fell behind. Asian countries did not get in the growth cum foreign savings policy and continued to have developmental societies” (Bresser-Pereira 2016; 8)*

Furthermore, there is evidence that proves the negative correlation between current account

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<sup>26</sup> Badkar Madma. *US current account deficit unexpectedly narrows in Q4. 2017. Financial Times.* Findable at: <https://www.ft.com/content/fd5c888b-5f1e-3977-86b5-cb1f813c4b73>

<sup>27</sup> Conerly Bill. *Future Of The Dollar As World Reserve Currency. 2013. Forbes.* Findable at: <https://www.forbes.com/sites/billconerly/2013/10/25/future-of-the-dollar-as-world-reserve-currency/#12fbd463e065>

<sup>28</sup> UNCTAD. *Trade and Development Report 2016. 2016. Press Release. Geneva.* Findable at: [http://unctad.org/en/PublicationsLibrary/tdr2016\\_en.pdf](http://unctad.org/en/PublicationsLibrary/tdr2016_en.pdf)

deficits and economic growth (World Bank 2014). Indeed, the premise that debt could help boost a country's economy could be refuted, most of developing countries run current account deficits, but the smaller they are, or the greater their current account surpluses are, the faster they grow.

However, open doors for foreign investment are still very recommended by the global organizations. Indeed, the United Nations publishes every year a ranking of the countries that receive the most direct investment every year and the rich countries always occupy the top of the list. Is like if they were telling the rest of the world that foreign direct investment is great because the developed countries allow it. What they do not present is the Net Values, these countries have the higher investments but also the higher outflows of investment, it means there is reciprocity in the investments. While on the other hand, FDI inflows in developing economies have risen remarkably, \$633Bn in 2015, and are in fact twice as high than outflows, \$307Bn for the same year. On the contrary, high-income countries report \$1.48 Trillions of inflows and \$1.52 Trillions of outflow for the same period of time.<sup>29</sup>

So it seems that the enormous amount of foreign direct investment that the developing countries have received over the last decades have not penetrated the economy heterogeneously. The capital goes in, but is not accountable for sustainable development or industrialization, nor for increasing the investment capacity of the country itself. There are two main reasons that explain this unfortunate outcome; the poor governmental work in managing investment and the undesirable behavior of multinational corporations in developing countries. There is indeed an intense debate in whether Multinationals are good or bad for developing countries, and even when there are significant positive points of letting multinationals enter in the local markets of Third World the strongest evidence indicates that over the long-run this does not bring real wealth for the hosting country.

Developing countries let Multinationals operate inside their territory in an effort to provide more jobs to the people and benefit from advanced technology that could not be produced locally. However, this happens at the expense of the exploitation of natural resources, environmental damage and a further unequal distribution of the profits. Over the past three decades, the volume of FDI in developing countries has been growing exponentially, from 1990 to 1996 FDI increased by 223 per cent worldwide and inflows in Latin America for example increased by 600 percent, which was the preferred destination for the United States. But what results intriguing is that the scale of those flows is not fully apparent in official statistics, the

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<sup>29</sup> Data World Bank. *Inflows and Outflows (BoP, current US dollars). 2015. Findable at: <http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?locations=XD-XP>*

CEPAL discovered that as much as 43 percent of the US-based FDI to the region was channeled through a number of financial centers in the Caribbean islands (Petrus James 2007; 41). This means in fact that Multinationals have channeled their profits as well through these fiscal paradises in order to avoid taxes in the developing hosts' countries.

In the latest World Investment Report 2015, the UNCTAD estimated that multinationals are shifting some \$450 billion a year in profits out of developing countries, leading to estimated losses of tax revenue of around \$100 billion a year in developing countries<sup>30</sup>. These losses hit very hard the Third World governments that have to shrink social spending as a consequence. The Periphery, once again, relies on the decisions of these Multinational Corporations that seems to serve not even the Center but just themselves.

Finally, this last part of the Capital chapter will examine a complex and very important point of dependency that could not be ignored, especially when it comes to investment and foreign capital; the soft power. This concept, first applied by Dr. Joseph Nye in 1990 described for the first time the powerful influence of the United States over the world in economic and social matters but done without money or the army. Soft power is about spreading values and convincing is about persuasion and transformation, is creating models and making them valuable at the others view. One model has particularly captured the attention of the world, American Financial System.

It seems like the whole world is shifting towards a much liberal system. The size of banking systems has increased; local currency bond markets have greatly developed, both in volumes and in reach over the yield curve; stock markets have expanded, and derivative markets—particularly currency derivatives—have grown and multiplied. According to the data of the World Bank, Market Capitalization has risen in Latin America from \$555 Billion in 2000 to more than \$1.5 Trillions in 2016. In North Africa and the Middle-East from \$886 Billion in 2009 to \$1.3 Trillion in 2016, India passed from \$230 Billion in 2003 to \$1.7 Trillion in 2016. But the most astonishing of all is the sharply rise of China stock market that grew 1479% in the last 13 years, it went from around \$420 Billion to \$6.6 Trillion in 2016. On the other hand, executive compensation has been increasing at much higher levels than the whole economy while debt still rising.

The chief executive commentator of the Financial Times Martin Wolf <sup>31</sup> describes the system

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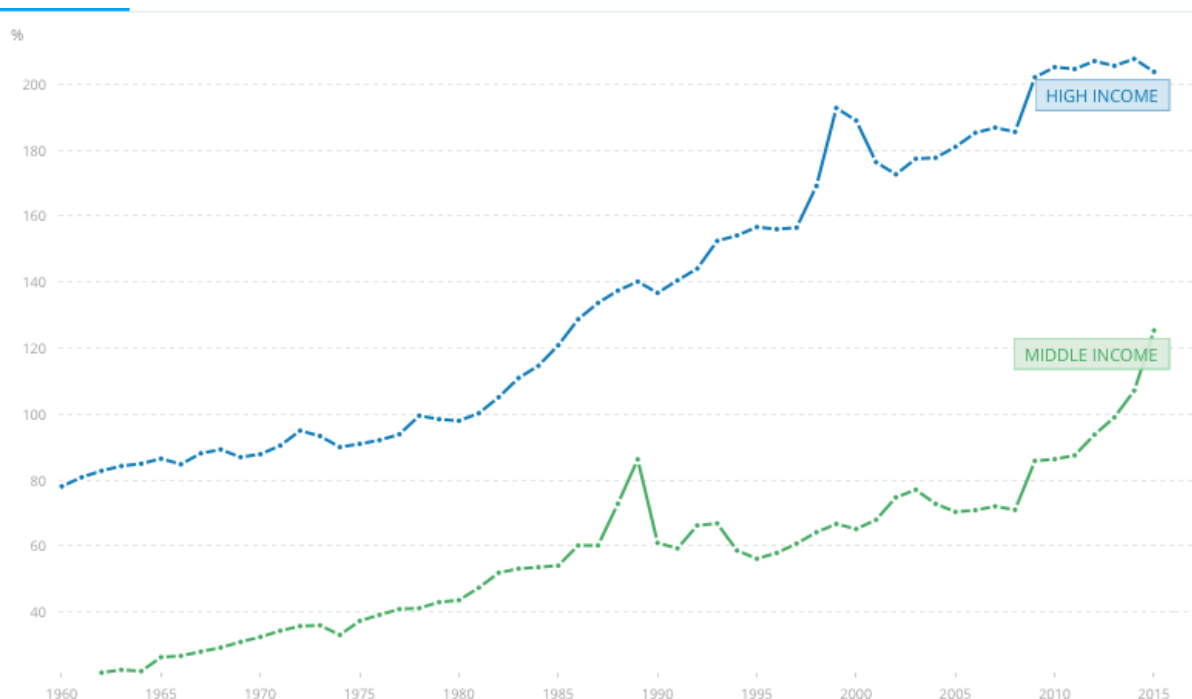
<sup>30</sup> Kituyi Mukhisa. *5 ways to make the taxation of multinationals fairer*. 2015. United Nations Press Release. Findable at: <http://www.un.org/esa/ffd/ffd3/blog/5-ways-taxation-of-multinationals-fairer.html>

<sup>31</sup> VIDEO FILE MARTIN WOLF

as unstable and very fragile, and explains that the major problem is that the financial sector has become extremely leveraged. The original intention of Finance, which was helping little and medium companies and people to project in the future, providing economic help, has now become a source of short-term millionaire income. It will be sufficient to look at the evolution of the banking assets to understand this (Figure 7). There is a rising trend in banking balance sheets without any repercussion in investment or growth. Very little of bank loans goes to low and medium scale enterprises, instead, credit is now used as source of investment for the stock market and that represents a real obstacle for industrialization and stimulation of demand.

More money is being created, more debt issued, more shares outstanding and more and more valuable, higher executives compensations, higher risk tolerance, more brokers, more investors, new derivatives and more complex ones, more and more trade, it all seems great but (ironically?) it is not. All of this is not creating more jobs, nor is improving the wages of the working people, on the contrary, is making those people exposed to unwilling and unknown risk.

### Domestic credit provided by financial sector (% of GDP) (Figure 7)



Source: World Bank 2016

So, a big problem could be arising from this Americanization of the Financial Sector, the world has already suffered from it in 2008, but if something like that happens evenly in all of the continents the damage would be unpredictable. This modern financial system that has been able to strength within Capitalism looks like a giant monster very difficult to stop, and the inability of the developing countries to fight against it constitutes another point of dependency.

#### 4. Conclusions.

It seems that more than half a century after the first publication of the Dependency School done by Frank in 1966 there are some important arguments that remain valid in the most modern problems of economy. It is clear that there have been many changes in the capitalist system since the beginning of the Industrial Revolution in the XIX, the essence, Capital Accumulation, remains the same but the paths for achieving that have diversified. Thus, the study of dependency becomes much more complex. However, it is possible to recuperate some important points result of the work.

- The first is that globalization has made International Trade unstoppable, it is at the core of almost every country in the world and the growth in transactions is exponential. Considering that, countries must find a fairer system for trade to happen. More than 50 years after the “Laissez Faire” period, the ideologies of free trade still are very controversial and do not respond to the needs of a must conscious population, whether it is because it destroys jobs or benefits a minority. It seems from the actual panorama that the same populism that born in Latin America in the sixties is now emerging in the Center countries and the future of global trade could expect some dramatic changes.
- The theories of Gunter Frank worked almost like a prediction of Globalization, the entire world is interconnected in a network of Metropolis and Satellites, and the relations between them are more tightened than ever before. Under this situation, the development of the Periphery only will be possible when they understand that the single way to achieve it is evenly and equally in all the territory when they realize that if the centers of

accumulation share their wealth to the satellites that would in return bring more wealth to those centers. But this does not mean transferring capital from one point to another, it means building the necessary infrastructure so the Satellites can produce by their own, it means teaching how to transform resources into capabilities and do it responsibly and sustainably.

- The new hidden point of dependency and probably the most dangerous is the Financial Sector that is growing at scale and threatens the stability of global economy. It looks like train that has already started and is very difficult to stop, it became an ambitious sector driven by the fantasy of extraordinary short-term profits with complete disregard to the possible consequences. There is indeed a big challenge for the coming years in finding measures to stabilize and solidify the system. It is in the hands of the developing countries to control the system because of they more than anyone need a trusted financial system to be able to project themselves in the future.
  
- It is necessary to highlight the problems that globalization, free trade, and foreign direct investment bring to the environment. The developing world rich in natural resources, and broad biodiversity is clearly the most affected by the behavior of multinationals. The world should not forget that even if it is separated by countries we all share the same planet and it would not be sustainable at this rhythm.

Sadly the future does not look uplifting, however, it remains in the hands of a new generation that hopefully for the fact that it grew up watching at these problems will take conscience and will fight for change. The interest I bring for the subject is my starting point.

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Map 2. Debt as % of GDP. Findable at: taken from <https://fr.actualitix.com/pays/wld/dette-publique-selon-pib.php>



